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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 382

IRVINE F. BELSER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals (R. 32-39) is reported at 174 F. 2d 386. The findings of fact and opinion of the Tax Court of the United States (R. 1-18) are reported at 10 T.C. 1031.

JURISDICTION

The judgment of the Court of Appeals (R. 40) was entered on May 2, 1949. A petition for rehearing (R. 41-54) was denied on June 13, 1949 (R. 55). In an order signed on September 8, 1949, Mr. Justice Jackson extended the time for filing a petition for a writ of certiorari to and including October 11, 1949 (R. 57). The petition for a writ of certiorari was filed on October 10,

1949. The jurisdiction of this Court is invoked under 28 U.S.C., Sec. 1254.

QUESTIONS PRESENTED

1. Whether there is evidence to support the Tax Court's finding that the taxpayer's stock in, and loans to, a certain corporation became worthless prior to the year 1932.

2. Whether the Tax Court committed reversible error in sustaining a 25 per centum addition to the tax provided by Section 291 of the Revenue Act of 1932 in cases in which a timely return is not filed or, if a return is filed late, the lateness is not shown to be attributable to reasonable cause and not to willful neglect.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses By Individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(j) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * *

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) *Time for Filing.*—

(1) *General Rule.*—Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

* * * * *

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file a return required by this title, within the time prescribed by law or prescribed by the Com-

missioner in pursuance of law, 25 per centum of the tax shall be added to the tax, except that when a return is filed after such time and it is shown that the failure to file it was due to reasonable cause and not due to willful neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

STATEMENT

The material portions of the findings of the Tax Court (R. 2-9) may be summarized as follows:

In 1919, the taxpayer contracted to purchase 331 acres of farm land from W. W. DePriest for $20,000 and another tract of about 424 acres from John W. Stewart for $21,202.50. In making these contracts he acted for himself and three other individuals. These four persons organized the Fairview Farming Company as a South Carolina corporation on December 11, 1919, to take title to these lands. (R. 2.)

Fairview Farming Company was organized with an authorized capitalization of $25,000 represented by 250 shares of common stock of $100

par value. Each of the four incorporators subscribed for 50 shares, paying $3,600 in cash and giving his promissory note for $1,400. On March 25, 1920, a certificate for 50 shares of stock was issued by the company to each of the incorporators. On the same day, two of them assigned their shares to the taxpayer and the other assigned his shares to the taxpayer's wife, the taxpayer becoming the beneficial owner of these latter shares. Each transferee received from the taxpayer $3,600 in cash and the taxpayer's note for $1,500 as consideration for the assignment, but because of the taxpayer's subsequent financial difficulties, payment of these notes was forgiven by the creditors. (R. 2-3.) Thus the taxpayer's cost of the capital stock of Fairview Farming Company was $14,400.

On January 6, 1920, DePriest conveyed the 331 acre tract to the company, which paid him $6,666.67 cash and gave him a mortgage on the property to secure payment of the balance of $13,333.33. On March 12, 1920, Stewart conveyed the 424 acre tract to the company, which paid him the $21,202.50 in cash. The funds needed beyond the company's capital were supplied by a bank loan of $10,000 secured by a mortgage on the Stewart tract, and by the taxpayer, who borrowed $12,000 by giving a mortgage on his home. (R. 2.)

These two tracts of land were the only assets Fairview Farming Company ever owned (R. 3).

In 1921, the company borrowed $1,000 from

the taxpayer, giving him a second mortgage on the DePriest tract, and the taxpayer borrowed $5,000 from his brother-in-law, which loan was secured by a third mortgage on the DePriest tract. The money procured was applied by the company to partial payment of the first mortgage note held by DePriest. When a further installment of the purchase price became due in 1922, the taxpayer and his wife, as sole directors and stockholders of the company, by resolution approved a sale of the tract to the taxpayer for $5 "for the purpose of facilitating a loan to take up the purchase money mortgage" and in view of the company's indebtedness to the taxpayer. The company conveyed the tract to the taxpayer by deed dated July 27, 1922, and on July 31, 1922, he conveyed it by mortgage deed to the First Carolinas Joint Stock Land Bank, to secure a loan of $7,200, which was used to pay off the purchase price. (R. 3.)

When the $10,000 note secured by the mortgage on the Stewart tract matured, the company paid off the debt by a $10,000 loan from the Fidelity Mutual Life Insurance Company, conveying the Stewart tract to the latter by a mortgage deed of December 4, 1920, to secure payment. On December 15, 1920, the company gave the taxpayer a second mortgage deed to this property to secure a $5,000 loan from him, and on January 27, 1923, gave the taxpayer a third mortgage deed to this property to secure a $3,500 loan from him. (R. 3.)

While the company was borrowing money

secured by mortgages on the two tracts, the taxpayer was using its shares as collateral for loans to him, individually. On November 30, 1921, he gave to the National Loan & Exchange Bank his notes for $14,350, $5,000, $1,661.04 and $150, respectively, all payable in one year and secured by 100 shares of the company, 125 shares of Clarendon Farms, Inc., the $5,000 note, due him, covered by a second mortgage on the Stewart tract, and certain share cropping agreements. While the 100 shares of the corporation were thus pledged as collateral, the taxpayer on March 14, 1922, had its authorized capital reduced to $5,000, but he neither notified the bank of this act nor cancelled any certificates. He defaulted on payment of all the notes; the bank sued, and on June 27, 1923, the court gave judgment against him for principal of $21,161.04, interest of $963.48, attorney's fees of $250, and costs of $7.40, or a total of $22,381.92, and ordered that if the judgment were unsatisfied within 90 days, the collateral be sold. On January 15, 1924, the company deeded the bank the Stewart tract subject to the $10,000 first mortgage, the $5,000 second mortgage, which latter the bank held as collateral, and the $3,500 third mortgage. (R. 3-4.)

On December 22, 1926, the corporation's charter was cancelled by the Secretary of State of South Carolina for nonpayment of the capital stock tax (R. 4).

On July 6, 1929, the taxpayer paid the bank

$1,000 on the judgment and the bank agreed that if he should pay $500 more by November 1, 1929, it would convey the Stewart tract to any person or corporation designated by him for the grantee's note of $18,500, secured by a first mortgage on the tract. The agreement contemplated removal of other mortgage liens; referred to the total payments involved ($1,000, $500, and $18,500), or $20,000 as "the purchase price" of the tract, and provided further that if the taxpayer should pay the bank $5,000 (inclusive of the $1,000 and $500 referred to) by November 1, 1933, the bank, at the taxpayer's election, would either satisfy its judgment or assign the judgment to any person or corporation designated by the taxpayer. In order that the bank could secure a first mortgage on the tract, the parties agreed that the taxpayer would either cancel or postpone the lien of the third mortgage, securing payment of the note for $3,500, and that the bank would cancel and satisfy the first mortgage securing the $10,000 loan of the Fidelity Mutual Life Insurance Company "as well as the mortgage of Fairview Farming Company to Irvine F. Belser, dated December 15, 1920" which secured taxpayer's $5,000 loan to the company and which had been assigned to the bank. The taxpayer formally declared the indebtedness of $3,500 satisfied and the third mortgage discharged by instrument dated February 28, 1930. (R. 4-5.)

The taxpayer made the payments required by

this agreement, and on February 28, 1930, organized the Fairview Company as a South Carolina corporation to take title to the Stewart tract. He acquired all of its 100 shares of stock, having an aggregate par value of $1,000. On February 28, 1930, the bank conveyed to Fairview the Stewart tract, and on March 15, 1930, the taxpayer conveyed to Fairview the DePriest tract. Fairview's charter was cancelled on December 10, 1930, for nonpayment of the capital stock tax. (R. 5.)

In 1932, the taxpayer paid off the note secured by the mortgage on the Stewart tract; the bank released its mortgage and on January 20, 1932, the bank assigned its judgment against the taxpayer to the taxpayer's brother, who acknowledged satisfaction and discharged the lien on June 14, 1939. The bank returned to the taxpayer the certificates for the 100 shares of Fairview Farming Company stock. About 1934 Fairview Company conveyed the DePriest tract to the taxpayer's wife, and the taxpayer acquired it by devise upon her death in 1942. The $7,200 note, secured by a first mortgage on it, was assigned by the bank to the taxpayer's brother on July 3, 1941, when the bank's note was paid, and by the brother to the taxpayer on September 14, 1942. On July 22, 1937, Fairview Company conveyed the Stewart tract to the taxpayer. (R. 5.)

Fairview Farming Company filed income tax returns for 1920, 1921, and 1922, reporting little income and no tax for 1920, losses for 1921 and

1922. It filed a form for 1923, on which was written: "This company has entirely ceased to do business." Fairview Company filed a return for 1931, reporting $100 gross income and deducting $600 interest and $100 taxes. (R. 5.)

The price of cotton ranged from a high of about 40 cents a pound in 1919 to a low of five cents a pound in 1932. Both the DePriest and Stewart tracts produced cotton. (R. 5-6.) The taxpayer contends that the low price of cotton and cotton real estate in 1932 caused his shares and mortgage notes to become worthless in that year (R. 13).

On an "amended income tax return" for 1932, submitted on July 12, 1937, the taxpayer deducted a loss of $24,000 on his investment in Fairview Farming Company. (R. 6.)

The Tax Court found that both taxpayer's stock in, and loans to, the Fairview Company became worthless prior to 1932 (R. 13).

On March 14, 1933, the taxpayer had requested in writing an extension of time for the filing of his income tax return for 1932. Upon several requests, the period was extended to September 15. Before September 15, the taxpayer requested a further extension, but the revenue agent in charge explained that no more time could be granted and suggested that the taxpayer submit an explanatory affidavit on filing the return late. (R. 8.)

On September 27, 1933, the taxpayer prepared a return for 1932, indicating a tax due of $59.92, and a letter of transmittal in which he stated that

delay was due to his preparation and trial of an important case for the Railroad Commission of South Carolina; that he enclosed his check for $62.05, covering the tax due and $2.10 interest. He left the return and enclosures with his secretary for mailing. His check was never returned to him by the bank as cashed and the Commissioner has no record of receipt of the return, letter or check. On October 30, 1933, the taxpayer prepared a state income tax return, using the same figures and accompanied by the same explanations of deductions that were attached to his federal return. The state return was received, and the enclosed check for the tax shown due was cashed. (R. 8.)

In May, 1935, a revenue agent called on the taxpayer to inquire why he had not filed a return for 1932. The taxpayer insisted that he had filed one. In view of this statement, the Collector's office procured from him successive consents, extending the period of assessment until June 30, 1939. On July 12, 1937, the taxpayer tendered to the Collector a copy of the return which he had prepared on September 27, 1933, and at the same time tendered an amended return for 1932, which indicated no tax due. (R. 8-9.)

On January 11, 1939, the Commissioner mailed to the taxpayer the notice of deficiency and penalty here involved. The computation was based on the premise that no income was reported and no liquidator has since acquired anything for

and correspondence with the taxpayer the Commissioner was fully aware of his deduction claims, and in the deficiency notice took cognizance thereof. In determining the deficiency, the Commissioner did not allow a deduction of the $24,000 here involved. (R. 9.)

The Tax Court found that evidence offered to support the contention that a return was mailed in September, 1933, was not convincing (R. 17-18) and sustained the Commissioner's imposition of the penalty (R. 18).

The Court of Appeals affirmed the Tax Court's rulings as to the deficiency and penalty (R. 32-40).

ARGUMENT

1. The question whether and when stock or debts become worthless is a question of fact having no general importance warranting the issuance of a writ of certiorari. There was, moreover, no error in finding that both taxpayer's stock in, and his loans to, the Fairview Farming Company became worthless prior to 1932. The test, as stated by the court below (R. 37), is one of "reasonableness, common sense and economic reality." At the time of the revocation of the charter of the Fairview Farming Company in 1926, it is quite clear that the stock was then worthless. The Tax Court found (R. 11) that "When its charter was revoked in 1926, there was nothing to liquidate; the shares had no value, and no liquidator has since acquired anything for

the payment of creditors or for liquidation." The taxpayer contends that such a finding is in conflict with local law (Pet. 19-21) in that the taxpayer held the property conveyed to him as trustee for the corporation's stockholders and creditors. However, it seems evident that the Tax Court was correct in stating (R. 11-12):

> But obviously petitioner was not holding any lands or assets in 1932 as trustee or otherwise for the corporation. Both tracts were then held by Fairview which had acquired one from petitioner and the other from a bank to which it had been transferred in consequence of a judgment not against the company but against petitioner. We could believe that initially the conveyance of the DePriest tract to petitioner for facilitating a mortgage loan was in furtherance of the company's interest, but any inference that a fiduciary character attached to his title is rebutted by the subsequent conveyance to Fairview. The tract was never reconveyed to the company, and petitioner did not again get title to it until his wife's death in 1942. * * *

The taxpayer also contends (Pet. 22) that the conclusion, that the $1,000 mortgage was merged by the conveyance of the DePriest tract to the taxpayer, is in conflict with governing local law. However, as stated in *Thompson* v. *Hudgens,* 161 S.C. 450, 456:

> The burden of overcoming the presumption in favor of merger rests upon him who denies

> that there was a merger; he must show by the preponderance of the evidence that it was the intention of the parties that there should be no merger.

The taxpayer has not satisfied that burden in the instant case, and in any event, the question involved is not of enough import to require a decision by this Court.

2. There was no error below in sustaining the Commissioner's imposition of a 25 per cent penalty on the taxpayer for failure to file an income tax return within the prescribed time. Section 291 of the Revenue Act of 1932 makes this penalty mandatory unless a return is filed at some time; hence, in the case of no return, the question of "reasonable cause" does not arise. The evidence supports the finding (R. 18) that a return was not mailed on September 27, 1933.[1] Contrariwise, the taxpayer asserts (Pet. 15) that in this respect, *Bouvelt Realty* v. *Commissioner,* 46 B.T.A. 45, is "on all fours with the case at bar" and supports the conclusion that a return was filed. However, the decisive factor in that case was summarized by the Board (p. 47):

> It was not until the collector wrote peti-

[1] Taxpayer contends (Pet. 17) that the Court of Appeals "has failed to give effect to the intention of the Congress in changing the rule laid down by this Court in *Dobson* v. *Commissioner,* 320 U.S. 489," rehearing denied, 321 U.S. 231. However, it seems clear that the Court of Appeals properly applied the "clearly erroneous" test of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869.

> tioners asking why the final returns had not been filed that a search through the office copies disclosed that the completed returns had not been filed. The returns were then immediately forwarded to the collector and duly filed.

Here, it was two years after being informed by the revenue agent that no return was received that the alleged return was finally submitted. In addition, as was stated in *Plunkett* v. *Commissioner,* 118 F. 2d 644, 650 (C.A. 1st):

> That the failure was due to inadvertence does not relieve the petitioner from the imposition of the penalty. The penalty is not primarily punitive in nature, but is an attempt to protect the revenue. * * *

It is clear then that there is no departure here from "the accepted and usual course of judicial proceedings" as suggested by the taxpayer. (Pet. 13.)

There is a further query as to whether the copy of the return filed in 1937 constituted a proper filing in view of the fact that a proper return must be signed and verified and the fact that a tardy return may be used to obstruct the operation and administration of the federal tax laws. As stated in *Plunkett* v. *Commissioner, supra,* p. 650:

> Nor do we believe that the return of October 10, 1938, can be considered a proper, though tardy, return. It was filed long after

> this suit was commenced. If such a practice were permitted, a taxpayer could file no return, and then, if such failure were detected and suit brought, he could file a properly executed return, and, by showing reasonable cause for not filing it *before the proper date,* avoid any penalty. * * *

Only in concluding that a proper return was filed either in 1933 or in 1937 do we reach the question of "reasonable cause." It is well-settled that the burden of establishing "reasonable cause" is on the taxpayer (*Girard Inv. Co.* v. *Commissioner,* 122 F. 2d 843 (C.A. 3d), certiorari denied, 314 U.S. 699), and what constitutes "reasonable cause" is a question of fact in the first instance for the Tax Court's determination (*Commissioner* v. *Lane-Wells Co.,* 321 U.S. 219). Taxpayer's suggestion (Pet. 15, Br. 34) that *Hatfried* v. *Commissioner,* 162 F. 2d 628 (C.A. 3d), is to the contrary is erroneous. That court states (p. 631) that "what constitutes 'reasonable cause' is a question of fact in the first instance for the Tax Court's determination."

When the taxpayer's check for payment of the 1932 tax was not returned in due course through his bank, it is only reasonable to assume that he should have known something was wrong. A revenue agent called upon him in 1935 to inquire why no return had been filed, yet he waited two more years before finally filing a purported return in 1937. There is nothing in the record to indicate

that this delay was due to reasonable cause and not to willful neglect, and thus, the Court of Appeals did not err in sustaining the imposition of the delinquency penalty.

CONCLUSION

The decision below is not in conflict with any other decision. It is fully supported by the facts and the law, and the petition for a writ of certiorari should be denied.

Respectfully submitted,

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